

STATE OF MICHIGAN
COURT OF APPEALS

KGI AUTOMOTIVE SYSTEMS, INC.,

Plaintiff-Appellee/Cross-Appellant,

v

INALFA ROOF SYSTEMS, INC.,

Defendant-Appellant/Cross-
Appellee.

UNPUBLISHED

December 26, 2013

No. 309612

Oakland Circuit Court

LC No. 2010-111682-CK

Before: BOONSTRA, P.J., and DONOFRIO and BECKERING, JJ.

PER CURIAM.

Defendant Inalfa Roof Systems, Inc. (Inalfa) appeals as of right the trial court's judgment in favor of plaintiff KGI Automotive Systems, Inc. (KGI) in the amount of \$168,090.20 plus interest and costs. KGI cross-appeals the same judgment, challenging the trial court's determination that setoffs that Inalfa took against KGI's invoices may be recoverable only in the context of a separate court action. Because the evidence supported the trial court's award of \$75,767 for raw materials and the court did not abuse its discretion by excluding the testimony of Michael Braun, but the court erred by awarding KGI damages for labor costs and administrative fees and by determining that the setoff issue was not properly before the court, we affirm in part, reverse in part, and remand for further proceedings.

I. FACTUAL BACKGROUND AND PROCEDURAL HISTORY

KGI supplies automotive parts, including seals, to companies that manufacture components for automotive products. Inalfa manufactures automotive roof systems, such as sunroofs, and was a customer of KGI. In 2008, KGI and Inalfa entered into an agreement whereby Inalfa purchased four types of rubber seals from KGI to use in Inalfa's production of sunroofs for General Motors and BMW. Inalfa sent KGI one purchase order for each of the four types of seals. The purchase orders along with Inalfa's "Terms and Conditions of Purchase" (Terms and Conditions) became part of the "purchase contract." Section 1 of the Terms and Conditions provided:

The term "Purchase Contract" shall be deemed to mean any purchase order or other agreement between Inalfa and the Supplier [i.e., KGI] in the performance of which goods are (to be) supplied to Inalfa and is deemed to consist of the purchase order, Releases (defined below) issued under the purchase

order, Quality Criteria (defined below), these Terms and all other documents specifically incorporated into or made a part of the Purchase Contract by Inalfa.

Regarding termination of the purchase contract, the Terms and Conditions stated, in relevant part:

6. TERMINATION AT OPTION OF INALFA.

The Purchase Contract may be terminated by Inalfa, at its option in whole or in part, for any or no reason, at any time or from time to time upon written notice of termination to Supplier.

6.1. Under termination by Inalfa under this Section, Supplier shall immediately stop all work under the Purchase Contract or portion of the Purchase Contract terminated and shall stop incurring costs and shall cause its suppliers to stop all such work and to stop incurring costs. To the extent of the terminated portion of the Purchase Contract and subject to any setoff rights of Inalfa, Inalfa shall pay to Supplier the following amounts without duplication: (1) The applicable price stated in the Purchase Contract for the applicable goods which have been completed and accepted by Inalfa and not previously paid for, but only to the extent there is an outstanding Purchase Contract and release for such goods and such goods do not exceed amounts scheduled and authorized in writing under delivery releases under the Purchase Contract to be delivered as of the date of termination, (2) The actual costs (exclusive of profit) incurred by Supplier for work-in-process which cannot reasonably be used by Supplier in producing supplies for itself or for its other customers (but only to the extent the amount of work-in-process is reasonable, in Inalfa's judgment) in light of outstanding Purchase Contracts, written releases, Inalfa's delivery schedules, and normal flow times, does not exceed amounts scheduled in writing to be delivered within ten days following termination (when added to finished goods in (1) above) and only if same is properly allocable under recognized commercial accounting practices to the terminated portion of the Purchase Contract), less the reasonable value thereof if actually used or sold by Supplier, and (3) The reasonable costs incurred by Supplier in protecting property in its possession in which Inalfa has or may acquire an interest if Inalfa has requested such protection in writing. The above payments shall not exceed the aggregate price specified in the applicable Purchase Contract for goods under express written delivery release authorizations from Inalfa outstanding at the date of termination, less: (1) Payments otherwise made or to be made; (2) The price of any non-conforming, defective, damaged or destroyed goods or goods for which acceptance has been subsequently rejected or revoked; (3) The price of any goods otherwise not accepted by Inalfa; and (4) The price of any goods that are readily marketable elsewhere.

* * *

6.3. Payment under this Section shall be Supplier's exclusive remedy and Inalfa's only liability in the event the Purchase Contract is terminated under this

Section. Upon such payment to Supplier, all right, title and interest in work-in-progress, goods and materials acquired by Supplier for the performance of the Purchase Contract shall immediately pass to Inalfa. Inalfa will not be liable to Supplier for any other costs, capital expenses, rental costs, soft costs, overhead, anticipated profits, damages, losses or any other amounts whatsoever upon termination other than as expressly set forth above.

According to Brian Ringler, an Inalfa employee, KGI had difficulty producing quality parts and meeting production requirements. As a result, in the summer of 2009 Inalfa began looking for different suppliers to replace KGI. The process of finding suppliers and building appropriate tooling took approximately eight or nine months, until the end of April 2010. During the eight or nine months, Inalfa never communicated to KGI that it was making efforts to replace KGI because Inalfa needed to rely on KGI until the new suppliers were ready to meet production demands.

On or about April 30, 2010, Inalfa sent KGI a letter stating that it was terminating its purchase contract with KGI effective April 23, 2010. Inalfa advised KGI to review and fulfill the duties and obligations set forth in § 6 of the Terms and Conditions, which required KGI to submit to Inalfa a claim for payment for the termination amounts set forth in ¶ 6.1. KGI submitted to Inalfa a claim for payment and an invoice that totaled \$232,483.92 for work-in-process, which included four components: (1) work-in-process material, (2) raw material, (3) labor, and (4) administrative fees. Inalfa paid KGI a total of \$184,371.12, but refused to make any payment for work-in-process. Thereafter, KGI filed this breach of contract action against Inalfa alleging that Inalfa failed to pay all the amounts owed as a result of its termination of the purchase contract. KGI also alleged that Inalfa improperly set off certain amounts against KGI's invoices for parts previously delivered to Inalfa and that, as a result, Inalfa owed KGI more than \$50,000 for previously delivered parts.

Inalfa moved for summary disposition pursuant to MCR 2.116(C)(10), arguing that KGI sought termination charges that were in excess of those permitted in § 6 of the Terms and Conditions and for costs and expenses that Inalfa never authorized. Inalfa asserted that KGI should have known that its costs and expenses were unauthorized because Inalfa began "zeroing out" future releases of product from KGI in its DELFOR weekly release schedules, thereby notifying KGI of its anticipated decline or elimination of future purchase requirements from KGI. Inalfa maintained that it paid KGI all of the termination charges to which KGI was entitled pursuant to the Terms and Conditions.

In response, KGI argued that Inalfa abruptly terminated the purchase contract without warning and that, in order to perform under the contract, KGI was prepared to fully produce for a nine-week period after termination. KGI maintained that it had obtained raw materials from its sub-suppliers using normal lead times and had to pay for the raw materials after Inalfa terminated the purchase contract. KGI argued that the Terms and Conditions specifically stated that KGI was entitled to recover from Inalfa for work-in-process in light of normal flow times. KGI also argued that Inalfa's DELFOR weekly releases specifically authorized KGI to procure materials and have in place all fabrication processes for the normal nine-week flow time. Thus, KGI contended, Inalfa's April 21, 2010, DELFOR release authorized KGI to obtain materials through June 20, 2010, and to be prepared for fabrication through May 9, 2010. KGI argued that

it had already purchased or committed to purchase raw materials and had labor commitments and manufacturing expenses to meet Inalfa's material and fabrication authorizations. KGI further asserted that Inalfa required it to be prepared to supply 1,500 seal modules each week and that it had to be prepared to supply the seal modules using a nine-week lead time. KGI argued that the same weekly releases that Inalfa contends showed a "zeroing out" also authorized KGI to purchase raw materials and be prepared for manufacturing for a nine-week period. According to KGI, Inalfa's termination of the purchase contract left KGI with work-in-process expenses totaling \$232,483.92, and Inalfa improperly credited itself approximately \$50,000 for alleged problems with delivery or parts that occurred several years previously.

The trial court determined that Inalfa was authorized to terminate the purchase contract pursuant to § 6 of the Terms and Conditions, but that there existed a genuine issue of material fact regarding damages. The court stated that KGI's damages were limited to those outlined in § 6.1 of the Terms and Conditions and did not include consequential, incidental, lost profits, or other damages. Accordingly, the trial court granted summary disposition for KGI regarding liability only and indicated that it would hold an evidentiary hearing regarding damages.

Following a four-day evidentiary hearing, the trial court ruled that KGI was entitled to a judgment in the amount of \$159,452.96, which included \$13,691 for work-in-process, \$75,767 for raw materials, \$43,520 for employee costs and employee retraining costs, and \$26,474.96 in administrative fees. The court determined that Inalfa's "pre-termination claims," which included Inalfa's setoffs for allegedly damaged, defective, and refused parts, incomplete deliveries, and freight costs, did not arise out of the termination of the purchase contract and, accordingly, were not within the scope of damages set forth in § 6 of the Terms and Conditions. The court opined that, to the extent that such claims are recoverable, the issue would have to be resolved in a separate lawsuit. Regarding KGI's claims for supplier costs incurred in protecting property in its possession, the trial court found that KGI hired and trained 17 employees to perform pursuant to the purchase contract, that KGI was able to transition some of those employees to other contracts and laid off the remaining employees, and that KGI incurred a cost to retrain the employees that remained. Thus, the trial court awarded \$43,520 for employee retraining costs and the cost of employees hired to perform under the purchase contract. On March 21, 2012, the trial court entered a judgment in KGI's favor in the amount of \$168,865.62, which included prejudgment interest. On April 2, 2012, the trial court entered an amended judgment in the amount of \$168,090.20 plus interest and costs.

II. STANDARDS OF REVIEW

We review for clear error a trial court's factual findings following an evidentiary hearing. See *Harbor Park Market, Inc v Gronda*, 277 Mich App 126, 130; 743 NW2d 585 (2007). "A trial court's findings are clearly erroneous only when the appellate court is left with a definite and firm conviction that a mistake has been made." *Id.* We review a trial court's legal conclusions de novo. *Id.* We also review de novo questions involving the proper interpretation of a contract. *Rory v Continental Ins Co*, 473 Mich 457, 464; 703 NW2d 23 (2005). This Court must examine the contractual language and accord words their plain and ordinary meanings. *Coates v Bastian Bros, Inc*, 276 Mich App 498, 503; 741 NW2d 539 (2007). An unambiguous contract reflects the parties' intent as a matter of law and must be enforced as written. *Id.* Further, this Court reviews for an abuse of discretion a trial court's decision whether to admit

evidence. *Waknin v Chamberlain*, 467 Mich 329, 332; 653 NW2d 176 (2002). An abuse of discretion occurs when the trial court's outcome falls outside the range of principled outcomes. *Corporan v Henton*, 282 Mich App 599, 605-606; 766 NW2d 903 (2009).

III. LEGAL ANALYSIS

Inalfa first argues that the trial court erred by applying a breach of contract damages analysis and awarding KGI breach of contract damages when the court previously held in its summary disposition ruling that Inalfa had a contractual right to terminate the purchase contract. Although the trial court erroneously cited boilerplate breach-of-contract law in its March 8, 2012, opinion, a review of the opinion shows that the court awarded only those damages to which it believed KGI was entitled under § 6.1 of the Terms and Conditions. In its opinion, the trial court acknowledged its previous ruling that KGI's damages were limited to those outlined in § 6 of the Terms and Conditions. The court stated that KGI had established its entitlement to "Section 6 Damages, which are defined in the following categories: (1) ordered and accepted goods; (2) work in progress or raw material; and (3) supplier costs incurred in protecting property [in] its possession." The court then analyzed KGI's separate claims for damages in the context of those categories. Thus, although the trial court erroneously cited law pertaining to breach-of-contract damages, the court's opinion indicates that it awarded only those damages to which it determined KGI was entitled pursuant to § 6.1 of the Terms and Conditions.

Inalfa also argues that the trial court erred by awarding damages that were outside the scope of those specified in § 6.1 of the Terms and Conditions. In particular, Inalfa challenges the trial court's award of \$43,520 for labor costs. Section 6.1 of the Terms and Conditions stated that KGI was entitled to recover damages from Inalfa, limited to three specific categories: (1) the price for goods that have been completed and accepted by Inalfa and not previously paid for, (2) the actual costs that KGI incurred for work-in-process that KGI cannot reasonably use in producing supplies for itself or for its other customers, and (3) the reasonable costs that KGI incurred protecting Inalfa's property in KGI's possession. The trial court awarded \$43,520 in labor costs under the third category as costs that KGI incurred protecting Inalfa's property in KGI's possession. The court's determination was erroneous because Sutinderpaul Kanwal, KGI's president, testified that KGI was not seeking labor costs as costs that KGI incurred protecting Inalfa's property in KGI's possession. Rather, Kanwal testified that KGI was seeking to recover its labor costs as costs that KGI incurred for work-in-process. Kanwal testified, "[s]o KGI incurred a cost to lay off those people based on what we had—we had people available to produce for the normal flow times or normal schedules that we are authorized to make and that's what we're claiming." KGI asserts that it must give its employees eight weeks' notice before it can stop paying them in a layoff situation. Kanwal further testified:

Q. Okay. But you're—you're not seeking the labor for making the parts, you're seeking a labor charge for laying people off?

A. That's correct.

Because KGI was not seeking to recover labor costs as an actual cost that it incurred for work-in-process, as stated in § 6.1 of the Terms and Conditions, the trial court erred by awarding KGI \$43,520 in labor costs. Section 6.1 did not authorize KGI to recover the costs that it

incurred in laying off employees. As stated in § 6.3 of the Terms and Conditions, payment under § 6.1 was KGI's exclusive remedy and Inalfa's only liability in the event that Inalfa terminated the purchase contract. The trial court therefore erred by awarding KGI labor costs that the parties' unambiguous contract did not authorize. A trial court must enforce an unambiguous contract as written. *Coates*, 276 Mich App at 503.

Inalfa also challenges the trial court's award of \$26,474.96 in administrative fees. Kanwal testified that the administrative fee was a standard 15-percent fee. In its brief on appeal, KGI asserts that the "fee is for the large amount of time and resources devoted by KGI to addressing the sudden termination by Inalfa without notice. Significant time and effort had to be diverted from KGI's other business to deal with KGI's suppliers, employees, manufacturing processes, conversion of its lines, development of its claim, and related activities." The trial court erred by awarding KGI damages for administrative fees because such damages were not authorized by § 6.1 of the Terms and Conditions. Administrative fees do not fall within any of the three categories of damages specifically authorized in § 6.1. Because § 6.3 of the Terms and Conditions limited KGI's damages to those set forth in § 6.1, the trial court erred by awarding damages for administrative fees, which were outside the scope of § 6.1 and therefore not authorized by the parties' contract.

Inalfa next argues that the trial court erred by awarding KGI \$75,767 for nine weeks' worth of raw materials that KGI alleged it was required to have on hand in order to perform under the purchase contract. Inalfa contends that the purchase contract authorized reimbursement only for raw materials that KGI acquired based on "express written delivery releases" from Inalfa and that Inalfa did not authorize the purchase of nine weeks' worth of raw materials. Inalfa further contends that the trial court erred by determining that planning volumes listed in the requests for quotation (RFQs)¹ constituted "express written delivery releases" and authorized KGI to acquire nine weeks' worth of raw materials.

Contrary to Inalfa's assertion, the trial court's opinion and order does not indicate that it relied on planning volumes in the RFQs in determining that KGI was authorized to have nine weeks' worth of raw materials on hand. Rather, the trial court relied on the DELFOR weekly releases, which provided a "material authorization" date nine weeks after the date of the release. The final DELFOR weekly release that Inalfa issued to KGI was dated April 21, 2010, two days before the effective termination date of the purchase contract, and indicated a "material authorization" end date of June 20, 2010. The trial court also relied on an e-mail from Ringler to Kanwal stating that KGI was required to produce 1,500 seals each week in order to satisfy the purchase contract. According to § 1 of the Terms and Conditions, the term "purchase contract" included releases issued pursuant to purchase orders. Further, Section 4.1 of the Terms and Conditions provided:

¹ According to Kanwal, the RFQ was a process in which both parties engaged before entering into the purchase contract. KGI received drawings, technical specifications, and projected quantity levels from Inalfa, and audits were conducted at KGI to determine its production costs in order to quote Inalfa a price for the contract.

Supplier shall strictly comply with the dates, times, quantities and instructions contained in the Purchase Contract and in any written requests from Inalfa for release of a specified amount of goods (“Releases”).

Thus, the contractual language required KGI to perform in accordance with the releases, which included the DELFOR weekly releases that contained material authorization end dates nine weeks after the date of the release. Therefore, the evidence showed that Inalfa authorized KGI to obtain nine weeks’ worth of raw materials in order to perform under the purchase contract.

Inalfa also contends that even if KGI was entitled to recover for nine weeks’ worth of raw materials, the trial court’s findings of fact regarding its award of \$75,767 for raw materials were clearly erroneous and unsupported by the evidence. Inalfa contends that KGI sought reimbursement for generic items, such as tape, hot glue, coatings, and packaging materials, that could be used in supplying other customers. Section 6.1 limits KGI’s damages to the actual costs that KGI incurred “for work-in-process which cannot reasonably be used by [KGI] in producing supplies for itself or for its other customers[.]” Inalfa opines that, subtracting the cost for raw materials that KGI could use for other contracts would decrease the damages amount from \$75,767 to \$17,733. Inalfa also contends that the amount of raw materials that KGI acquired to perform under the purchase contract was excessive and well in excess of a nine-week supply of materials. Inalfa relies on § 6.1 of the Terms and Conditions, which provided that KGI was entitled to reimbursement for its actual costs incurred “only to the extent the amount of work-in-process is reasonable, in Inalfa’s judgment[.]”

The trial court determined that KGI was entitled to “recover one hundred percent (100%) of its raw material costs[.]” which totaled \$75,767. It appears that the court credited the testimony of Kanwal and Linda Caron, a KGI employee, who testified that the raw material costs sought were for raw materials purchased for use in fulfilling KGI’s contract with Inalfa and were within the normal nine-week lead time. In addition, Kanwal testified that KGI reduced its claim for raw materials by approximately \$25,000 on the final day of the evidentiary hearing because, in the 18 months after submitting its claim to Inalfa, KGI was able to put a portion of the materials to other use. Although Ringler testified that he believed that KGI could put certain materials to other use and that the amount of materials was excessive based on his estimations, the trial court apparently credited Kanwal’s and Caron’s testimony in this regard. Moreover, Ringler admitted that he was not an expert like KGI in the industry. Thus, the evidence adduced at the evidentiary hearing supported the trial court’s award of \$75,767 for raw materials.

Inalfa next argues that the trial court erred by excluding the testimony of Michael Braun. Inalfa’s attorney sought to call Braun to testify on the second day of the evidentiary hearing, but counsel for KGI objected on the basis that Braun was not listed on Inalfa’s witness lists. Inalfa’s attorney responded that Braun was not employed at Inalfa at the time that the witness lists were filed, and that the personnel at Inalfa who could have testified regarding the DELFOR reports were no longer employed there. The trial court ruled that Inalfa could have filed an amended or supplemental witness list, but failed to do so.

The trial court did not abuse its discretion by excluding Braun’s testimony. As the trial court ruled, Inalfa could have filed an amended or supplemental witness list that included Braun. In addition, in Inalfa’s offer of proof regarding Braun’s testimony, counsel for Inalfa indicated

that Braun would testify regarding the DELFOR reports. Because Braun was not employed at Inalfa before Inalfa terminated the purchase contract, however, Braun did not have personal knowledge regarding the particular DELFOR reports relevant to this dispute. Moreover, counsel for Inalfa acknowledged that Braun's testimony would be similar to Caron's testimony and that, in any event, Ringler would testify on behalf of Inalfa. Although Inalfa contends that KGI did not object when Braun attended the first day of the evidentiary hearing and his name was placed on the record, KGI had no reason to object merely because an Inalfa employee attended the hearing. Because the trial court's decision did not fall outside the range of principled outcomes, the court did not abuse its discretion by excluding Braun's testimony. *Corporan*, 282 Mich App at 605-606.

On cross-appeal, KGI argues that the trial court properly determined that Inalfa was not entitled to set off \$49,880.96 from KGI's invoices for products previously delivered, but that the court erred by holding that such amount was recoverable only in the context of a separate action. Inalfa disputes that the trial court determined that Inalfa was not entitled to set off \$49,880.96 from KGI's invoices, but agrees with KGI that the court erred by holding that it did not have jurisdiction to determine the setoff issue.

A review of the trial court's opinion and order shows that the trial court determined that the setoff issue, or Inalfa's "pre-termination claims" as the court characterized the issue, did not arise out of Inalfa's termination of the purchase contract and that Inalfa was not entitled "to pre-termination claims because [they were] not within the scope of Section 6 Damages[.]" The court further stated that, "[t]o the extent that pre-termination claims may be recoverable, the issue must be resolved in a separate lawsuit." Thus, contrary to KGI's assertion, the trial court did not determine that Inalfa was not entitled to a setoff. Rather, the court opined that the issue was not properly before it because the court did not believe that the setoff issue was within the scope of § 6 damages.

The trial court erred by determining that the setoff issue was not properly before it. Section 6.1 of the Terms and Conditions allowed KGI to collect specific, enumerated damages "subject to any setoff rights of Inalfa." The provision further stated:

The above payments shall not exceed the aggregate price specified in the applicable Purchase Contract for goods under express written delivery release authorizations from Inalfa outstanding at the date of termination, less: (1) Payments otherwise made or to be made; (2) *The price of any non-conforming, defective, damaged or destroyed goods or goods for which acceptance has been subsequently rejected or revoked*; (3) *The price of any goods otherwise not accepted by Inalfa*; and (4) The price of any goods that are readily marketable elsewhere. [Emphasis added.]

At the evidentiary hearing, Ringler testified regarding the setoff, which included amounts for nonconforming and defective products and products that Inalfa refused. Thus, pursuant to the language of the parties' contract, the setoff was properly within the scope of damages allowed under § 6.1, and the trial court should have determined whether Inalfa was entitled to a setoff and, if so, the amount of the setoff. We therefore remand this case to the trial court for a determination regarding that issue.

Affirmed in part, reversed in part, and remanded for further proceedings consistent with this opinion. We do not retain jurisdiction. Neither party having prevailed in full, no costs are taxable pursuant to MCR 7.219.

/s/ Mark T. Boonstra
/s/ Pat M. Donofrio
/s/ Jane M. Beckering